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Supreme Court of the United States.

OCTOBER TERM, 1940.

EVERETT WARE CADY ET AL., PETITIONERS,

v.

CLIFFORD J. MURPHY, RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT AND BRIEF IN SUPPORT THEREOF.

Petition.

To the Honourable the Justices of the Supreme Court of the United States:

The undersigned, on behalf of Everett Ware Cady, Alfred E. Thurber, W. Palmer Dixon, Hollis Hunnewell, Fred Zettler, E. Mauran Beals, Jr., Herbert N. Rawlins, Jr., Willis P. Beal, Arthur N. McGeoch, Jr., James Averell Clark, Henry Parish II, Alexander R. McKernan, Sidney B. Curtis, John Harsen Rhoades, and George Sloane, petitioners, pray that a writ of certiorari may issue to review the judgment of the Circuit Court of Appeals for the First Circuit entered August 15, 1940, in the case between the above-named parties, docketed therein as No. 3570, affirming the judgment of the District Court for the District of Maine, wherein the petitioners were defendants and the respondent plaintiff.

OPINIONS BELOW.

The opinion of the District Court (Rec. pp. 285-292) is published in 30 Fed. Supp. 466. The opinions in the Circuit

Court of Appeals (Rec. pp. 299-305) are published in 113 F. (2d) 988.

Jurisdiction.

The final judgment of the Circuit Court of Appeals was entered August 15, 1940 (Rec. p. 306).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended, U.S.C. Title 28, Section 347.

The jurisdiction of the District Court was based upon diversity of citizenship.

Questions Presented.

The fundamental question presented is whether a stock-exchange firm which acts solely as broker for the purchaser of a security from whom by interstate telephone calls it has solicited an order to buy can be held liable as a seller of said security under Section 12(2) of the Securities Act for misrepresentations of fact regarding the security purchased.

There is likewise presented the question of practice whether, under the Rules of Civil Procedure, upon an appeal in a law action tried without a jury, it is competent for the Circuit Court of Appeals itself to make a finding of fact not made by the District Judge and to decide the case upon the basis of that finding.

Statute Involved.

Section 12 of the Securities Act of 1933 reads as follows:

"Sec. 12. Any person who—

"(1) sells a security in violation of section 5, or

"(2) sells a security (whether or not exempted by

the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Definitions of terms are found in Section 2, as follows:

"Sec. 2. When used in this title, unless the context otherwise requires . . .

"(3) The term 'sale', 'sell', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; . . .

"(12) The term 'dealer' means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person . . ."

The Circuit Court of Appeals was of the opinion that the following provisions of Sections 4 and 5 were pertinent to the decision of the case:

> "Sec. 4. The provisions of section 5 shall not apply to any of the following transactions:
>
> "(1) Transactions by any person other than an issuer, underwriter, or dealer; . . .
>
> "(2) Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders . . .
>
> "Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> "(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; . . ."

Statement of the Case.

The respondent is a small broker and dealer in securities doing business in Portland, Maine, under the style of "Clifford J. Murphy Co." The petitioners at all material dates were members of the stock-brokerage firm of Rhoades & Company carrying on a general brokerage business with offices in New York and Boston. They likewise maintained a branch office in Portland and through that had had numerous dealings with the respondent over a period of years (Rec. pp. 10-12).

In the late winter of 1937 one Lynch, a trader in the petitioners' Boston office, by telephone to Portland recommended to the respondent a stock subsequently identified

as South American Utilities. In the course of the recommendations which he made to the respondent, Lynch made statements which unquestionably were not in accord with the facts and which he might have ascertained were not true. There was a clear split in testimony between Lynch and the respondent as to whether these statements were made as statements of fact or as specifically designated repetition of hearsay information received by Lynch. The judge found on sufficient evidence that the respondent was justified in accepting them as being made as statements of fact (Rec. p. 288) and the petitioners make no contention here that these representations would not have supported recovery in the event that Section 12(2) of the Securities Act applied to the case.

Early in March, 1937, the respondent purchased 1700 shares of the stock at the price of $4.50 per share. It was stipulated by the parties that the 1700 shares were part of a block of 1970 which Lynch ordered by means of one telephone conversation between Boston and New York (Rec. p. 281). The stock was purchased from E. E. Smith & Co., a small unlisted dealer in New York. The petitioners' records show that the 1700 shares were purchased by the petitioners as brokers for the account of the respondent (Exh. 5a, Rec. p. 257; Exh. H, Rec. p. 275). The petitioners charged the respondent a commission of four cents a share, or $68 (Exh. C, Rec. p. 270, and Exh. H, Rec. p. 275). From this the petitioners paid a clearance fee of two cents, so that their net profit and sole gain on the transaction was $34 (Rec. pp. 134, 135).

The parties were sharply at issue as to whether the telephone conversation at which the respondent admittedly ordered the 1700 shares took place on March 1 or March 3, 1937. The respondent drew his writ (Rec. pp. 2-4) and tried his case upon the theory that the petitioners were acting as principals and not as brokers. His contention that

the conversation took place on March 3 was urged to show that they were acting as principals. On this issue the trial judge found and stated in his opinion:

> "For the benefit of the defendants I will say that the evidence is not sufficient to satisfy me that the defendants owned this stock and sold it as principals" (Rec. p. 290).

In fact, the intrinsic value of the stock was materially less than the $4.50 per share which the respondent paid for it, and not long after the purchase it declined on the market. The respondent then tendered it back to the petitioners and demanded a return of the money he had paid. The tender was refused and the action was brought in the District Court for the District of Maine as a common-law action on the case (under the old practice), commenced by writ dated October 6, 1937 (Rec. p. 36). Subsequently the respondent disposed of most of the stock for less than he had paid. The declaration (Rec. pp. 2-4) contained one count at common law for deceit and three counts under Section 12(2) of the Securities Act of 1933.

The trial judge found and ruled for the petitioners on the common-law count, so no question is presented with reference to it.

On the counts under the Securities Act the respondent offered evidence attempting to show that the stock was sold by the petitioners as owners. He likewise contended that, even though the petitioners acted as brokers, the Securities Act would apply and justify recovery. The petitioners insisted that they acted solely as brokers for the respondent and that under a proper construction of the act it gave no cause of action to a customer against his broker. There was no dispute between the parties that, if the petitioners were owners of the stock, the statute would apply, and no

contention was made that the petitioners had acted as brokers for E. E. Smith & Co., who had owned the stock before the transaction of March 1. The sole issue of law was whether Section 12 could apply when in fact the petitioners had acted as brokers for the respondent. As stated above, the judge did not find that the petitioners had acted as principals. On this sole issue of law he construed the word "sell" in Section 12 in the broadest manner possible, and proceeded to rule:

> "Whether the seller, being a broker, himself owns the security, or whether he is acting as the agent for the owners, or for the purchaser, or for both, is immaterial" (Rec. p. 291).

He consequently denied the petitioners' seventh and eighth requests for rulings, which read:

> "7. Section 77(l) of Title 15, U.S.C.A. (Section 12 of the Securities Act of 1933) has no application, except as between the vendor of a security and the vendee.
>
> "8. Said section has no application to the case where the plaintiff is a purchaser of securities and the defendant has acted merely as his broker" (Rec. p. 284).

Judgment was entered for the respondent (Rec. p. 293) and the petitioners appealed to the Circuit Court of Appeals.

That court affirmed the judgment of the District Court, but it did so upon a finding of fact made by it and not by the District Judge. The majority opinion quoted the ruling of the trial judge set out above as to the immateriality of the relationship, and said:

> "We need not decide whether Section 12(2) applies to the case of a broker acting solely for a purchaser, where the broker makes misrepresentations in the course of soliciting from the purchaser an order to buy.

> Even if the version of the defendants' witness Lynch is accepted, Rhoades & Company was acting either as agent for the seller or in a dual capacity as agent for both parties, in either of which cases Section 12(2) is applicable" (Rec. p. 304).

The District Judge had not found that the petitioners were acting as agent for the seller or in any dual capacity. No contention had been made to that effect, either at the trial or prior to the conclusion of the oral argument before the Circuit Court of Appeals. In that court a brief had been filed by an *amicus curiae* in which the sole argument made was that a person acting solely as broker for the purchaser could not come within the statute. In a reply to this brief, filed a fortnight after the conclusion of the oral arguments, the respondent for the first time advanced the contention that the petitioners had acted as agents for E. E. Smith & Co., the owner of the stock. This contention thus advanced was adopted by the majority of the Circuit Court of Appeals and was embodied in Judge Magruder's opinion as an essential finding of fact.

Judge McLellan, in a dissenting opinion, held that—

> "There was abundant evidence, which would have justified, if it did not require, a finding that the defendant acted not as agent for the seller but as agent for the plaintiff who was the buyer"—

and went on to say:

> "To me, it seems, that one who acts solely as agent for the purchaser cannot be regarded as a seller and that the liability of such an agent for misrepresentations rests upon common law principles, not upon the Securities Act which relates to misrepresentations by a seller.

"The trial judge having proceeded upon a contrary view, I think justice requires that the judgment of the District Court be set aside and a new trial ordered" (Rec. p. 305).

Specification of Errors.

The Circuit Court of Appeals erred:

1. In affirming the judgment of the District Court entered upon a ruling of law by the District Judge to the effect that Section 12(2) of the Securities Act of 1933 could give a cause of action to a purchaser of securities against his own broker.

2. In making a finding of fact in an action at law tried before a judge sitting without a jury, which finding was not made by the trial judge and which finding was essential to the affirmance of the judgment upon the legal theory adopted by the Circuit Court of Appeals in affirming the judgment.

3. In refusing to grant a new trial where the order for judgment of the trial judge was based upon a ruling erroneous upon a material particular.

4. In affirming the judgment of the District Court.

Reasons for Granting the Writ.

(1) The Circuit Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. The action was upon the law side of the court. The District Judge refused to find that the petitioners sold the stock in question to the respondent as principals. He ruled as a matter of law that it was immaterial whether the petitioners acted as brokers for the respondent, or for the owner of the stock, or both. He made no finding that the petitioners'

agent acted in any manner "as agent for the seller or in a dual capacity as agent for both parties." The case was not tried in the District Court or argued before the Circuit Court of Appeals on any issue of whether the petitioners' agent was acting for the seller. The Circuit Court of Appeals prompted by respondent's reply to the brief of the *amicus* made a finding of fact not made by the District Judge and decided the case solely upon the basis of this finding and refused to consider the issue of law tried in the District Court and argued before the Circuit Court of Appeals. There is no provision in the Rules of Civil Procedure which purports to give additional fact finding powers to the Circuit Courts of Appeals not vested in those courts before the adoption of the Rules of Civil Procedure. There is no reported case in which a Circuit Court of Appeals in a civil action in the nature of an action at law tried without a jury has itself made a finding of fact not made by the District Judge and has affirmed a judgment upon the basis of that finding. The reported decisions in the several circuits leave in doubt whether under the new rules such an action is open *de novo* in the Circuit Court of Appeals. This practice point is of great importance and should now be settled by the opinion of this Court.

(2) The issue presented in the case involves the decision by a divided Circuit Court of Appeals of an important question of federal law which has not been but should be settled by this Court. Prior to the decisions in this case no court had passed upon the question of whether the provisions of Section 12(2) of the Securities Act of 1933 imposed liability upon a party acting solely as a broker for the purchaser. The statute imposes a new and onerous liability in connection with sales of securities. It is important in the interests of dealers in securities that the scope of this liability should be authoritatively settled and this can be done only by a decision of this Court. The decision of the District Court

is direct authority that a broker soliciting an order to purchase from his own customer and executing for him the order thus obtained comes within the scope of the statute. The majority opinion of the Circuit Court of Appeals refuses to consider this point. The dissenting opinion of Judge McLellan construes the statute as not applying to such a situation.

The result of the three opinions is to leave the state of the law on this important point in grave doubt. By settling it at this time in this case this Court may administer prophylactic justice to buyers and sellers of securities generally.

The practical importance of this decision to the entire brokerage profession is evident and is manifested by the fact that the Boston Association of Stock Exchange Firms filed a brief in the Circuit Court of Appeals as *amicus curiae*. The decision of the Circuit Court of Appeals has also been made the subject of a special article appearing in the Wall Street Journal for Tuesday, September 3, 1940, and of special releases of the Securities and Exchange Commission dated August 30, 1940, in which the Securities and Exchange Commission assert that the Circuit Court of Appeals for the First Circuit "rendered an opinion under section 12 (2) of the Securities Act of 1933 holding that a broker *acting as agent for the seller of securities* was liable to the purchaser for misrepresentations made in the sale." (Italics supplied.)

Prayer.

Wherefore your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Court directed to the Circuit Court of Appeals for the First Circuit commanding said court to certify and send to this Court on a day certain to be therein designated a full and complete transcript of the record and all proceedings of the

said Circuit Court of Appeals in this case which was entitled in that court: *Everett Ware Cady et al., doing business under the firm name and style of Rhoades & Company, Defendants, Appellants,* v. *Clifford J. Murphy, doing business under the firm name and style of Clifford J. Murphy Co., Plaintiff, Appellee,* No. 3570, to the end that said cause may be reviewed and determined by this Court as provided by Section 240 of the Judicial Code as amended (U.S.C. Title 28, § 374), and that your petitioners may have such other and further relief or remedy in the premises as to this Court may seem appropriate and that the said judgment of said Circuit Court of Appeals in the said case may be reversed by this Honourable Court and your petitioners will ever pray.

EVERETT WARE CADY,
ALFRED E. THURBER,
W. PALMER DIXON,
HOLLIS HUNNEWELL,
FRED ZETTLER,
E. MAURAN BEALS, JR.,
HERBERT N. RAWLINS, JR.,
WILLIS P. BEAL,
ARTHUR N. McGEOCH, JR.,
JAMES AVERELL CLARK,
HENRY PARISH II,
ALEXANDER R. McKERNAN,
SIDNEY B. CURTIS,
JOHN HARSEN RHOADES, AND
GEORGE SLOANE,
By RICHARD WAIT,
ROBERT HALE,
Counsel for Petitioners.

Dated October 17, 1940.

STATE OF MAINE, }
CUMBERLAND, } ss.

Robert Hale, being duly sworn, says that he is counsel for Everett Ware Cady, Alfred E. Thurber, W. Palmer Dixon, Hollis Hunnewell, Fred Zettler, E. Mauran Beals, Jr., Herbert N. Rawlins, Jr., Willis P. Beal, Arthur N. McGeoch, Jr., James Averell Clark, Henry Parish II, Alexander R. McKernan, Sidney B. Curtis, John Harsen Rhoades and George Sloane, the petitioners herein; that he prepared the foregoing petition and that the allegations thereof are true as he verily believes.

ROBERT HALE.

Sworn to and subscribed before me, this 17th day of October, 1940.

LEON V. WALKER, JR.,
Notary Public.